VZCZCXRO0028
RR RUEHAG RUEHDF RUEHIK RUEHLZ RUEHROV
DE RUEHDL #1189/01 2890939
ZNR UUUUU ZZH
R 160939Z OCT 06
FM AMEMBASSY DUBLIN
TO RUEHC/SECSTATE WASHDC 7570
INFO RUCNMEM/EU MEMBER STATES
RUEHBS/USEU BRUSSELS

UNCLAS SECTION 01 OF 02 DUBLIN 001189

SIPDIS

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: EAIR PREL ECON EI
SUBJECT: HOLDING PATTERN FOR RYANAIR TAKEOVER BID OF AER
LINGUS

REF: COLEMAN-YOUNG E-MAIL OF OCTOBER 10 AND PREVIOUS

¶1. (SBU) Summary: As Ryanair's takeover bid for Aer Lingus has slowed over the past week, Irish attention has focused on the approach that EU Commission competition authorities will take toward the envisioned merger. Ryanair now holds a 19-percent stake in Aer Lingus, with the Government retaining its 28-percent stake and employees buying additional shares to increase their stake to 15 percent. Although Ryanair has not formally notified the EU Commission about its takeover bid, the Irish Government has started to prepare its case for DG Competition, with no apparent plans to request a referral to the Irish Competition Authority. Ryanair remains confident that DG Competition will decide it its favor, while an Irish aviation consultant told Post that the two airlines' overlapping routes will make the EU's decision too close to call. A Ryanair representative also criticized Irish Government comments questioning Aer Lingus' continued exercise of rights under the U.S.-Irish aviation agreement as an attempt to spook investors. As the competition case takes shape, Ryanair CEO Michael O'Leary is in a strong position, having obtained, at least, a sizable stake in his primary competitor and additional leverage over decisions regarding the construction of Dublin Airport's second terminal. End summary.

## Takeover Bid Update

¶2. (U) The overall stake held by low-cost airline Ryanair in the recently privatized Irish national carrier, Aer Lingus, has hovered just above 19 percent since Ryanair CEO Michael O'Leary announced a surprise takeover bid for Aer Lingus on October 5. On October 13, Aer Lingus stock finished trading on the Dublin Stock Exchange at euro 2.90 per share, as compared to Ryanair's offer price of euro 2.80 and Aer Lingus' original flotation price of euro 2.20. In an apparent move to obstruct Ryanair's takeover bid, a group of Aer Lingus pilots purchased an additional 2-percent stake in the airline on October 10, increasing the stake held by employees to nearly 15 percent. The October 13 Irish Times reported that a separate group of employees was considering the use of pension funds to purchase an additional 6-percent stake. The Government's stake remains roughly 28 percent, with both Finance Minister Brian Cowen and Transport Minister Martin Cullen reiterating in recent days that the Government would retain its shares in the interest of aviation competition. (The Government reduced its 34-percent stake to 28 percent within the first two days of Aer Lingus' flotation, although Government officials had stated that they would sell off this 6-percent stake slowly to ensure against volatile initial trading.)

## The Looming Competition Case

¶3. (SBU) The EU Commission's competition authorities will soon take center state on Ryanair's takeover bid, Noreen Mackey, the Legal Advisor to the Irish Competition Authority, told Pol/Econ Chief on October 13 (repeating press coverage on this likelihood). Mackey explained that, under Ireland's 1997 Takeover Panel Act, Ryanair had 28 days from the October 5 date of its takeover bid announcement to mail a share offer to shareholders, a step that Ryanair had not yet taken. Ryanair would then be obligated to notify DG Competition about the bid, since the Ryanair-Aer Lingus entity would meet the necessary thresholds: operations in at least three EU Member States and combined turnover exceeding euro 100 million. DG Competition would have roughly four months to make a ruling, with no further recourse to Ireland's Competition Authority. Mackey cited press reports that the Irish Government had begun to prepare a case for the Commission with help from Goldman Sachs, which had retained former Competition Commissioner Mario Monti as an advisor. In other words, the Irish Competition Authority had no plans at this point to exercise its right under EU legislation to seek referral of the Ryanair case from DG Competition.

¶4. (SBU) DG Competition's ruling on the Ryanair bid will be too close to call, Pol/Econ Chief was told on October 14 by John Finnegan, Principal Consultant for Goodbody Economic Consultants (an arm of the brokerage that advised the Government on the Aer Lingus flotation) and formerly an official in DG Competition's aviation office during Commissioner Monti's tenure. Finnegan observed that DG Competition's instinctive opposition to airline alliances in the 1990s had given way to a posture supportive of carrier consolidation. In approving the Air France-KLM merger, for example, DG Competition noted that the airlines had different hubs and that rail links between France and the Netherlands



provided consumers with transport options alternative to aviation. The differences in the Ryanair-Aer Lingus case, Finnegan remarked, were that the rail link alternative was moot and that the two airlines together would have a strengthened position at Dublin, their shared hub. Moreover, the two carriers had a number of overlapping city-pair routes (19 to the same airports and 26 to the same city, counting Ryanair's service to secondary airports for the cities in question). Finnegan questioned whether DG Competition could use landing slot forfeitures as an effective remedy in approving the takeover, since it was unclear whether other airlines would jump onto the routes that the two airlines now serve from/to Dublin.

¶5. (SBU) Ryanair is confident that EU competition authorities will look favorably on the takeover bid, Ryanair Director of Regulatory Affairs, Jim Callahan, explained to Pol/Econ Chief on October 12. He noted that DG Competition had demonstrated a consistent record in support of airline consolidation, such as in Germany, France, the UK, and Scandinavia. Callahan observed that the takeover would serve consumer interests, as the application of Ryanair's low-cost model would help to reduce Aer Lingus' fares. The takeover made sense in the context of relative size, with Ryanair carrying 42 million passengers per year compared to Aer Lingus' 8 million, and with Ryanair's fleet more than triple the size of the Aer Lingus fleet. Aer Lingus, Callahan added, was a "small player" in the European and trans-Atlantic markets, and Government resistance to the takeover bid reflected an "emotional, politically driven" reluctance to lose control of the former national carrier. Because Ryanair CEO Michael O'Leary believed strongly in Aer Lingus' potential for enhanced shareholder returns, moreover, Ryanair would not sell its Aer Lingus shares even if the takeover bid were to fail, Callahan added.

## Questions about the U.S.-Irish Aviation Agreement

¶6. (SBU) Callahan described Transport Minister Cullen's

October 6 comments questioning Aer Lingus' continued exercise of rights under the U.S.-Ireland air transport agreement in a takeover scenario as an attempt to spook investors and to distract attention from the Government's failure to anticipate the Ryanair bid. (Cullen raised the questions after media reports noted that Ryanair might not be over 50 percent Irish-owned.) Callahan said that Ryanair was 54 percent EU-owned, but "probably not" more than 50 percent Irish-owned. Reiterating points made by Ryanair CEO O'Leary to the October 8 Sunday Business Post, Callahan said that Ryanair was nonetheless Irish-registered, Irish-regulated, Irish-headquartered, and Irish-managed and did not have rights to fly outside the EU from other EU Member States under existing aviation agreements.

Comment: O'Leary Strongly Positioned
------------------------------------

¶7. (SBU) The famously flamboyant Ryanair CEO, Michael O'Leary, appears to be strongly positioned whether or not the takeover bid succeeds. Ryanair reportedly had euro 2 billion in available cash to launch the takeover, and he should have sufficient reserves to improve its share price offer, up to euro 3.50 by some estimates. If DG Competition approves the bid and if Ryanair can obtain a 51 percent stake, O'Leary will be the first low-cost airline executive in Europe to take control of a legacy carrier. If DG Competition disapproves or if Ryanair cannot reach the 51 percent threshold, O'Leary will still have a sizable stake in his primary competitor, with the value of his investment having already increased 30 percent based on Aer Lingus' initial and current share prices. Perhaps as importantly, O'Leary will have more leverage over decisions to be made regarding the planned construction of Dublin Airport's second terminal, which was to cater primarily to Aer Lingus. O'Leary will likely highlight his strong position as he attempts to describe the wisdom of his gambit to Ryanair shareholders, many of whom are still reportedly skeptical about the envisioned merger.
BENTON